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C O N F I D E N T I A L SECTION 01 OF 03 MOSCOW 000057

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DEPT FOR EUR/RUS WARLICK, HOLMAN, AND GUHA
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DOC FOR 4231/IEP/EUR/JBROUGHER
NSC FOR GRAHAM AND MCKIBBEN

E.O. 12958: DECL: 01/10/2017
TAGS: EPET ENRG ECON PREL RS
SUBJECT: RUSSIAN ENERGY: THE RUSSIA-BELARUS OIL STANDOFF

REF: A. MOSCOW 13174
¶B. WARSAW 33
¶C. BERLIN 45

Classified By: CDA Daniel A. Russell. Reasons 1.4 (b/d).

¶1. (C) SUMMARY: Russia and Belarus have not yet found a solution to their row over oil volumes through the Druzhba pipeline. Over the last three days each party has cast blame on the other for initiating the confrontation, with the Russians claiming that the Belarusian transit duty was illegal under existing agreements and Belarus blasting Russia's recently imposed export duty. Before negotiations can begin (the Russians are characterizing the talks so far as "contact"), Russia is insisting that Belarus drop the transit duty and begin sending oil through the pipeline. The GOR says that oil relations should be governed by a 1995 intergovernmental agreement (IGA) under which the only authorized duty is the Russian crude oil export tariff. Energy Minister Khristenko has asked Russian oil companies to start making plans to cut back production -- an eventuality that Gref told the German Embassy may come as early as this weekend. However, both the MFA and a representative from Rosneft have told us that the issue may be resolved before that. In the end, a resolution to this problem revolves around finding the right "price," something which will likely involve a compromise on sharing tax revenues from the Belarusian refined products exports produced using Russian crude.

¶2. (SBU) Late on January 8, MEDT's Deputy Minister Andrey Sharonov and Transneft officials confirmed that Russia had stopped shipping oil via the Druzhba through Belarus to Europe. This decision followed a claim by Transneft President Semyon Vainshtok that Belarus had begun diverting Europe-bound oil for domestic use. (Note: some 1/3 of Russian crude exports, or 1.35 million b/d, flow through Belarus to world markets.) Responses from GOB and Belarusian oil industry officials ranged from denial to admitting that it happened but explaining the seizure as "payment" -- in lieu of cash -- of the recently-imposed $6.50/barrel transit fee Belarus imposed on oil through the Druzhba. EU Energy Commissioner Piebalgs said that the situation posed "no immediate risk" to energy supplies in the EU. According to Moscow sources, Poland has 80 days of oil reserves and Germany has 130 (Refs A and B).

¶3. (SBU) As of the evening of January 9, The GOR and GOB had not found a solution to end the oil cutoff. According to

press reports, Economic Development and Trade (MEDT) Minister German Gref met with Belarusian Deputy Prime Minister Andrey Kobyakov for what Gref described as "preparation for talks." Repeating the mantra employed by other Russian officials, Gref insisted that for negotiations to begin in earnest the GOB must start transiting Russian oil again and repeal the transit duty Belarus imposed on Russian exports to Europe. Further, Russian President Vladimir Putin hinted at the possibility of reducing oil production if this dispute drags on. (Note: Russia is very short on excess refining capacity, so this sector can do little to mop up the excess oil)

¶4. (C) Shawn McCormick (please protect), head of government affairs at TNK-BP, told us that during an emergency meeting the evening of January 9, Minister Khristenko told Transneft and seven Russian oil producers that Russia will not accept Belarus's imposed $6.50/barrel transit duty and that both sides must return to the 1995 intergovernmental agreement (IGA) under which the only authorized tax is the Russian export duty on crude oil. Furthermore, Russia is insisting that Belarus agree to the longstanding practice of splitting the export tax revenue Belarus earns from refined products produced from Russian crude. The traditional split is 85/15 in Russia's favor as opposed to Belarus's desired 60/40 split.

¶5. (C) Khristenko verified that the northern Druzhba line remained shut down and warned that the dispute could go on for a prolonged period. Russia believes that western customers have a comfortable three weeks of oil storage. Transneft said that its 3-day storage capacity would be full by COB January 10. After this, production itself may need to be shut-in and Khristenko requested the producers to restrict output accordingly. For example, McCormick told us, TNK-BP's

production cut could amount to 375,000 b/d -- about one-quarter of the company's daily production.

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DUELING TAXES

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¶6. (SBU) While undoubtedly influenced by the acrimonious gas row (Ref A) the proximate cause of the situation is the recent oil-related taxes the two countries have imposed on each other. Russia announced in December that it would begin levying a $180/ton export duty on oil sold to Belarus. Russian officials justified this export duty saying that the GOB had not lived up to the terms of the 1995 IGA regarding the splitting of export tariff revenues that Belarus receives from the sale of refined products produced from Russian crude. Belarus responded by slapping the transit fee on Russian oil transiting through the Druzhba. Transneft has not paid this fee, claiming it is illegal under existing agreements, prompting Belarus to begin legal proceedings against Transneft and its President, Semyon Vainshtok.

¶7. (C) McCormick confirmed the lack of progress in the talks but indicated that the Russian side wants to end the stand-off "in days, not weeks." He also said that the $45/ton transit fee would cost Russian shippers, at current volumes, $3.7 billion per year -- $700 million from TNK-BP itself. In addition, TNK-BP oil traders said that they were looking at other ways to get the oil to Europe (via the shipping terminal at Primorsk and through Ukraine) but their options are limited due to capacity constraints on these routes. Oleg Butsenko, Rosneft's export division chief told us that, for commercial reasons, his company's exports to Belarus fell after the imposition of the Russian export duty but that they don't plan to abandon the route. He said not to "over-dramatize" the situation, though, hinting that he thought the matter could be settled quickly.

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THE RUSSIAN MFA TAKE

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¶8. (C) Victor Sorokin, Director of the MFA,s Second CIS Department (Belarus, Moldova and Ukraine), emphasized the positive in recent developments, noting that the GOR was satisfied with the finalization of its &gas relationships8 with all former Soviet republics by adding the final piece -- Belarus -- to the puzzle. Sorokin defended the rise in gas prices and imposition of oil duties as overdue measures to move Russian-Belarusian relations to market terms. There was no near-term prospect of a union state that would justify preferential treatment for Belarus, and Sorokin repeated that the GOR had no interest in forcing such an arrangement and no intent of moving along the constitutional path that would be required to realize it. Russia and Belarus remain two separate sovereign states, where market-driven pricing and conditions should apply -- to both oil and gas.

¶9. (C) Sorokin predicted a resolution in the "nearest future,' and noted contacts that there have been continuous contacts between the two countries at all levels to resolve the latest oil impasse -- between Lukashenko and Putin; between the Prime Ministers Sidorskiy and Fradkov; between Foreign Ministers Martynov and Lavrov; and (currently in Moscow) between Deputy Prime Minister Kobyakov and Economic Development and Trade Minister Gref. Sorokin underlined that the meetings in Moscow are not &negotiations8 but &contacts,8 since Russia was not prepared to compromise on the imposition of the oil tariff. He reminded us of the 1995 IGA which Belarus willfully started ignoring several years ago. Gref, who is heading the Russian side, Sorokin stressed, was one of the most liberal members of the Putin cabinet and did not subscribe to an energy "stick." Belarus's behavior was unacceptable, according to any market norms.

¶10. (C) Sorokin refrained from criticizing Lukashenko personally, other than to note relations remained "complicated." He repeatedly said that the Belarusian leader has no choice but to initiate economic reform in the country and break out of the counter-productive isolation. Russia could no longer subsidize Belarus, but Belarus remained a "special friend," and still received the lowest gas price among all Gazprom's customers. He emphasized that once this new paradigm is understood, the talks can move fast to a

resolution.

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COMMENT

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¶11. (C) Cutting through the tit-for-tat in the press, it becomes apparent that this boils down to finding the right "price." It is virtually impossible to predict with any certainty what this price may be, but any deal will likely involve a compromise on the split of export tax revenue Belarus makes from sales of refined products. Furthermore, the longer this drags on the more skittish Russian shippers are likely to become. This combined with the mounting damage to Russia's reputation argues for a relatively swift conclusion to this impasse. Putin's resolve on such issues, however, is notoriously strong regardless of reputational damage. Another wildcard is Lukashenko and whether he is willing to go to the mat to show he can stand up to Russia. In the long run, Russia will find alternatives to the Druzhba, an aging route with bothersome middlemen standing between Russian oil and the cash it generates when sold in the West. In the short run, however, the potential oil production cuts and relocation of exports could be disruptive to oil markets.
RUSSELL